

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES FOR THE)	
WHISPERING HILLS SANITARY)	
SEWERS-DIVISION OF GEORGE E.)	CASE NO. 8491
BUISSON REALTY CO., INC., OF)	
JEFFERSON COUNTY, KENTUCKY)	

O R D E R

PROCEDURAL BACKGROUND

On March 30, 1982, the Whispering Hills Sanitary Sewers, a division of George E. Buisson Realty Co., Inc., ("Whispering Hills") filed an application with the Commission seeking approval of an increase in its sewer rates. The proposed rates would produce an increase in gross annual revenues of approximately \$81,426, or 86.55 percent above test period revenues. The Commission in this Order has allowed rates to produce an increase in revenues of \$78,309.

Public hearings were held in this matter on July 13, 1982, and August 31, 1982, in the Commission's offices in Frankfort, Kentucky. The Consumer Protection Division of the Attorney General's office was permitted to intervene. Moreover, counsel for the owner of several apartment buildings and an individual customer served by Whispering

Hills made statements for the record. All additional information requested has been filed.

ANALYSIS AND DETERMINATION

Test Period

For the purpose of determining the reasonableness of the proposed rates, the 12-month period ending December 31, 1981, has been accepted as the test period.

Valuation Method

Whispering Hills proposed no specific valuation method in its application. The Commission has found that Whispering Hills' investment records are insufficient in detail to allow it to determine a proper investment rate base or capitalization for rate-making purposes. The Commission has used the operating ratio method as the basis in determining sewer rates for the past several years and finds that the results of this method have been reasonable and fair. Therefore, the Commission is of the opinion that the operating ratio method should be used in this case, as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues} \text{ (Less Revenues to Cover Interest)}}$$

Revenues and Expenses

Whispering Hills proposed several pro forma adjustments to actual operating revenues and expenses. The Commission finds these adjustments reasonable and has accepted them for rate-making purposes with the following exceptions:

Management Fee

Whispering Hills' test period expenses included \$5,000 compensation for management services. All routine service operations are performed by Buisson Realty Wastewater Control and all billing and collection is performed by the Louisville Water Company. Thus, the functions performed by Whispering Hills' management are limited to part-time administrative duties. Based on its experience with other similarly-operated sewer utilities, the Commission is of the opinion that \$5,000 for management services is excessive and should be reduced to a reasonable level of \$2,500.

Chemicals

Whispering Hills' projected cost of chemicals of \$2,430 included \$210 for a drum deposit. Drum deposits are refundable and are not an operating expense. Therefore, the Commission has denied this portion of Whispering Hills' pro forma adjustment to the test period expense for chemicals.

Repairs and Maintenance Expense

An analysis of individual invoices of repairs and maintenance expense totalling \$11,167 showed that during the

test period Whispering Hills purchased furnace coils for \$119, exhaust fans for \$899 and 120 feet of 4-inch PVC pipe, tees and related materials for \$1,246. The Commission considers these purchases to be capital items and has, therefore, deleted them from test period operating expenses. Moreover, Whispering Hills proposed a 10 percent adjustment (\$1,117) to repairs and maintenance expenses for inflation. Whispering Hills provided no documentation to support this adjustment and the Commission has disallowed it as it is contrary to Commission policy to allow the inclusion of speculative adjustments for rate-making purposes.

Depreciation Expense

The Commission is of the opinion that in accordance with the Uniform System of Accounts for sewer utilities, depreciation expense should be computed on the straight-line method for rate-making purposes, and has adjusted depreciation expense in this Order accordingly. Further, the Commission, in its disallowance of capital items of \$2,264 included in the cost of repairs and maintenance expense described above has allowed a pro forma adjustment of \$266 computed on the basis of the expected useful lives of each capital item.^{1/}

^{1/}	Furnace Coils:	\$ 119	÷ 5 years	= \$ 24
	Exhaust Fans:	899	÷ 5 years	= 180
	PVC pipe, etc.:	1246	÷ 20 years	= 62
		<u>\$2264</u>		<u>\$266</u>

Moreover, the Commission has made an additional adjustment to depreciation expense of \$16,770 following an analysis and determination that the cost of sewer lines in the amount of \$335,394 previously charged to operating expenses by Whispering Hills should be capitalized on the investment records with an offsetting adjustment to retained earnings. The Commission has herein allowed annual depreciation expense based on the 20-year useful life of the lines. Whispering Hills should further analyze the dates the lines were placed into service to reflect an accurate record of accumulated depreciation.

Rate Case Expense

Whispering Hills included estimated rate case expense of \$10,000 amortized over a 3-year period in its pro forma test period expenses. Whispering Hills substantiated this amount by invoices from its attorney and accountant who prepared this case. Although Whispering Hills has incurred the expense, the Commission is of the opinion that the amount is excessive. The Commission has made a comparison of fees paid by similar utilities for these services and has determined that \$6,000 amortized over 3 years is a reasonable and fair amount for Whispering Hills' ratepayers to pay.

Interest on Long-Term Debt

Whispering Hills proposed an adjustment of \$96,340 to its pro forma operating expenses for interest on its debt to the Buisson Investment Corporation. The accumulated debt at

December 31, 1981, is as follows:

Principal Balance	\$ 691,194
Accrued Interest	<u>411,867</u>
Total	<u>\$1,103,061</u>

Whispering Hills computed interest at 5 percent on the accumulated debt of \$1,103,061, or \$55,153, and proposed to amortize the accrued interest of \$411,867 over 10 years at \$41,187 annually.

The inclusion of the adjustment of \$41,187 to retire accrued interest on long-term debt has been disallowed by the Commission. Recovery for this item as for principal retirement should be from depreciation expense and net income.

Income Taxes

Federal and state corporate income tax and the Jefferson County tax expense of \$3,584 have been computed by the Commission on the basis of taxable income of \$17,644 after the granted increase using the composite tax rate of 18.52 percent.^{2/}

Therefore, Whispering Hills' adjusted operations at the end of the test period are as follows:

^{2/} \$17,644 (Gross taxable income) - \$388 (2.2 percent Jefferson County tax) x 18.52 percent (federal and state corporate composite tax rate) = \$3,196.

	<u>Actual</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$ 94,078	\$ -0	\$ 94,078
Operating Expenses	86,742	16,434	103,176
Net Operating Income	\$ 7,336	\$ (16,434)	\$ (9,098)
Interest Expense	53,107	2,046	55,153
Net Income (Loss)	<u>\$ (45,771)</u>	<u>\$ (18,480)</u>	<u>\$ (64,251)</u>

Revenue Requirements

The Commission is of the opinion that Whispering Hills' adjusted operating loss is unfair, unjust and unreasonable. The Commission is further of the opinion that an operating ratio of 88 percent is fair, just and reasonable in that it will allow Whispering Hills to meet its expenses and provide a reasonable surplus for equity growth. Therefore, the Commission finds that Whispering Hills should be permitted to increase its rates to produce an increase in annual revenue of \$78,309.^{3/}

FINDINGS AND ORDER

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A should produce gross annual revenues of approximately \$172,387 from 1448 customers

$$\begin{array}{l} \text{3/} \\ \$99,590 \div 84.95\% = \$117,234 + \$55,153 - \$94,078 = \\ \$78,309. \end{array}$$

and are the fair, just and reasonable rates for Whispering Hills to charge for sewer service.

2. The rates proposed by Whispering Hills would produce revenues in excess of those found reasonable herein and should be denied upon application of KRS 278.030.

3. Whispering Hills has filed a valid third-party beneficiary agreement with the Commission.

4. Whispering Hills should make appropriate adjusting entries to adjust its plant, accumulated depreciation and retained earnings accounts to capitalize the cost of capital assets previously charged to expense.

IT IS THEREFORE ORDERED that the rates in Appendix A are the fair, just and reasonable rates for Whispering Hills to charge for sewer service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Whispering Hills be and they hereby are denied.

IT IS FURTHER ORDERED that Whispering Hills shall make appropriate adjustment entries to its accounts as described in finding number 4, and shall file a copy of its adjusting entries with the Commission within 90 days of the date of this Order.

IT IS FURTHER ORDERED that within 20 days of the date of this Order, Whispering Hills shall file with the Commission its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing sewer service.

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8491 DATED SEPTEMBER
28, 1982

The following rates are prescribed for the customers served
by Whispering Hills Sanitary Sewers located in Jefferson County,
Kentucky:

<u>Customer Category</u>	<u>Monthly Rate</u>
Single Family Residence	\$ 12.19
One Bedroom Apartment	6.09
Two Bedroom Apartment	8.61
Coin Laundry	\$ 170.00
Whispering Hills Country Club	135.00
Pro Bowl II Bowling Alley	135.00
Whispering Hills Liquor Store	\$ 17.17
Whispering Hills Barber Shop	17.17
Majik Market	17.17
Derby City Auto Lot	17.17
Castaway Lounge	17.17
Real Estate Office	17.17
Beauty Shop	17.17